



# Annual Audit Letter 2014/15

London Borough of Tower Hamlets

—

November 2016



# Contents

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Page

## Report sections

— Headlines 3

## Appendices

1. Key issues and recommendations 7
2. Summary of reports issues 10
3. Audit fees 11

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External auditors do not act as a substitute for the audited body's own responsibility for putting in place proper arrangements to ensure that public business is conducted in accordance with the law and proper standards, and that public money is safeguarded and properly accounted for, and used economically, efficiently and effectively.

We are committed to providing you with a high quality service. If you have any concerns or are dissatisfied with any part of KPMG's work, in the first instance you should contact Andrew Sayers, the engagement lead to the Authority (and the national lead partner for all of KPMG's work under our contract with Public Sector Audit Appointments Limited), who will try to resolve your complaint. After this, if you are still dissatisfied with how your complaint has been handled you can access PSAA's complaints procedure by emailing [generalenquiries@psaa.co.uk](mailto:generalenquiries@psaa.co.uk), by telephoning 020 7072 7445 or by writing to Public Sector Audit Appointments Limited, 3rd Floor, Local Government House, Smith Square, London, SW1P 3HZ.

**This Annual Audit Letter summarises the outcome from our audit work at the London Borough of Tower Hamlets in relation to the 2014/15 audit year.**

**Although it is addressed to Members of the Authority, it is also intended to communicate these key messages to key external stakeholders, including members of the public, and will be placed on the Authority's website.**

This final letter summarises the key findings arising from:

- our audit work at the Authority in relation to the Authority's 2014/15 financial statements and those of the Local Government Pension Scheme it administers ('the Pension Fund'); and
- the work undertaken to support our 2014/15 conclusion on the Authority's arrangements to secure economy, efficiency and effectiveness in its use of resources ('VFM conclusion').

The qualification to the VFM conclusion that we issued in relation to the 2013/14 financial year and applying our risk-based approach to VFM work, means that we have needed to expand our work to support our 2014/15 VFM conclusion, as explained in our *External Audit Plan 2014/15*. This work has included:

- assessing the potential VFM risks and identifying the residual audit risks for our VFM conclusion;
- considering the results of any relevant work by the Authority and other inspectorates and review agencies in relation to these risk areas;
- considering the 'Best Value Inspection of London Borough of Tower Hamlets' report (the Best Value Inspection report) produced by PricewaterhouseCoopers LLP (PwC), dated 16 October 2014, and published by the Secretary of State for Communities and Local Government (SoS CLG) on 4 November 2014;
- understanding the Authority's response to the BV Inspection report and completing sufficient work to assess the progress made by the Authority in addressing the issues raised;
- consideration of other matters brought to our attention by the Tower Hamlets Commissioners; and the Department for Communities and Local Government (DCLG); and
- following up on relevant issues included in our *Final ISA 260 Report 2013/14* issued on 8 October 2015.

# Headlines (cont)

Having completed our additional work related to the qualified VFM conclusion in 2013/14 we were able to issue our audit opinion and 2014/15 VFM conclusion on 12 October 2016. The financial statements audit opinion was unqualified but the VFM conclusion was issued subject to an adverse qualification.

<p><b>VFM conclusion and VFM risk areas</b></p>	<p>We issued a qualified conclusion on the Authority's arrangements to secure VFM for 2014/15 on 12 October 2016.</p> <p>This means we are not satisfied that during the year the Authority had appropriate arrangements for securing economy, efficiency and effectiveness in the use of its resources throughout the 2014/15 financial year.</p> <p>We identified three VFM key areas of focus in our External audit plan 2014/15: Medium Term Financial Standing; response to the Best Value Inspection findings; and Governance in Authority Schools. We worked with officers throughout the year to discuss these VFM areas of focus.</p> <p>We issued an adverse opinion in respect of the Authority's arrangements to secure VFM for 2013/14 on 8 October 2015. The qualification reflected the matters raised in the Best Value Inspection report where the Authority had failed to comply with its best value duty in relation to:</p> <ul style="list-style-type: none"> <li>■ Payment of grants and connected decisions;</li> <li>■ The disposal of property and the granting of leasehold interests; and</li> <li>■ Spending on publicity.</li> </ul> <p>In addition to the above specific points, the Best Value Inspection report also commented that the Authority's corporate governance arrangements did not appear to be capable of preventing or responding appropriately to failures of the best value duty in the areas highlighted above. Comments within the Mayoral election judgment and arising from the other matters raised with us as auditors also indicated that the governance processes had not always been effective.</p> <p>In relation to 2014/15 it is important to note that the Best Value Inspection report was only published in November 2014. Subsequently the SoS CLG appointed Commissioners to undertake an executive decision-making role in relation to all grant decisions, and to oversee the work of the Authority in specified areas of operation in December 2014. The Commissioners also play a consultative role in the development of a plan to deal with weaknesses in the processes for entering into contracts identified in the report, but are not able to issue binding directions to the Authority except in circumstances where the Authority fails to adopt recommendations of the statutory officers. Thus the Authority only formally became aware of the concerns and issues raised and their seriousness later in the 2014/15 financial year.</p> <p>Furthermore, the Commissioners reported in March 2015 that they were not satisfied with the progress that the Authority was making to address the issues included in the Directions issued by the SoS.</p> <p>These circumstances therefore resulted in the adverse opinion in respect of the Authority's arrangements to secure value for money on similar grounds to those set out in our 2013/14 opinion.</p>
<p><b>Audit opinion</b></p>	<p>We issued an unqualified opinion on the Authority's 2014/15 financial statements on 12 October 2016. This means that we believe the financial statements give a true and fair view of the financial position of the Authority and of its expenditure and income for the year. The financial statements also include those of the pension fund.</p>

## Section one

# Headlines (cont)

Having completed our additional work related to the qualified VFM conclusion in 2013/14 we were able to issue our audit opinion and 2014/15 VFM conclusion on 12 October 2016. The financial statements audit opinion was unqualified but the VFM conclusion was issued subject to an adverse qualification.

<b>Financial statements audit</b>	<p>Our audit has not identified any material or significant audit adjustments. We identified a small number of presentational adjustments required to ensure that the accounts are compliant with the <i>Code of Practice on Local Authority Accounting in the United Kingdom 2014/15</i>. There have been no changes that affect the General Fund or HRA balances or the Authority's net worth as at 31 March 2015.</p> <p>We identified the following key financial statements audit risks in our 2014/15 External audit plan issued in June 2015.</p> <ul style="list-style-type: none"> <li>■ Property, Plant and Equipment;</li> <li>■ Payment of Grants;</li> <li>■ Accounting for Local Authority Maintained Schools; and</li> <li>■ Section 106 Agreements.</li> </ul> <p>We worked with officers throughout the year to discuss these key risks. There were no significant matters, in relation to our audit of the financial statements, arising as a result of our audit work in these key risk areas.</p> <p>We noted that the Authority has maintained the quality of the accounts and the supporting working papers. Officers dealt efficiently with audit queries.</p>
<b>Annual Governance Statement</b>	<p>We reviewed your Annual Governance Statement and concluded that it was consistent with our understanding and did not identify any issues.</p>
<b>Pension Fund audit</b>	<p>There were no significant issues arising from our audit of the Pension Fund and we issued an unqualified opinion on the Pension Fund financial statements as part of our audit report.</p>
<b>ISA 260 Report 2013/14</b>	<p>The Authority has implemented the recommendations in our <i>Final and Interim ISA 260 Reports 2013/14</i> relating to the financial statements. In terms of those relating to VFM we have summarised the position in Appendix 1.</p>
<b>High priority recommendations</b>	<p>We did not raise any new high priority recommendations as a result of our 2014/15 audit work.</p>
<b>Objection concluded</b>	<p>We have completed our consideration of one objection received in relation to the Authority's 2014/15 financial statements. The objection related to the Best Value Inspection and the fee that was charged to the Authority by the DCLG. We were requested to apply to court that the fee should be declared an unlawful item of account; and also to consider whether a public interest report should be issued. Having considered the matters raised we concluded that we would not take any action in relation to the Best Value inspection ie that we would not apply to the court for an unlawful item of account to be declared and that there were no issues that required a public interest report.</p>

## Section one

# Headlines (cont)

We have outstanding objections and therefore are not yet able to confirm the completion of our audit responsibilities for the 2014/15 audit year.

<b>Certificate</b>	<p>We have two objections from Local Government Electors that we are considering. One is in relation to parking matters and the Authority's 2013/14 financial statements. The other objection refers to the Authority's Lender Option Borrower Option loans and relates to 2014/15.</p> <p>Until we have completed our consideration of these objections we will not be in a position to formally conclude the audit and issue an audit certificate.</p>
<b>Audit fee</b>	<p>Our fee for 2014/15 to date is £299,529, excluding VAT (the fee for 2013/14 was £369,089, excluding VAT). We expect that the final fee will be higher, as we have not yet included any fee for dealing with the objection relating to Lender Option Borrower Option loans. Further detail is contained in Appendix 3.</p>

# Appendix 1: Position on 2013/14 key issues and recommendations

## Follow up of previous recommendations

As part of our audit work we followed up on the Authority's progress against previous audit recommendations. The position on the four high priority recommendations followed up in 2016 are set out in this Appendix.

No.	Issue and recommendation	Position as at September 2016
1	<p><b>Declarations of Interest</b></p> <p>The Best Value Inspection report refers to several instances where there are relationships with other parties. The Best Value Inspection report does not conclude as to whether these relationships represented significant concerns or were improper. However, there appears to be the potential for interests that should be declared not being so, possibly due to incomplete knowledge about who the Authority is doing business with, or seeking to do business with. As a minimum this gives the potential for reputational damage to the Authority.</p> <p><b>Recommendation</b></p> <p>The Authority should:</p> <ol style="list-style-type: none"> <li>1. Review its policies, procedures and processes for identifying potential interests and ensuring declarations are up to date and complete;</li> <li>2. Consider whether improvements can be made to ensure relevant members and officers are aware of organisations and individuals seeking to do business with or interact with the Authority; and</li> <li>3. Ensure that all relevant members and officers receive at least annual training and reminders about their responsibilities and the need to ensure interest declarations are complete and up to date.</li> </ol>	<p>The Authority has strengthened its arrangements, for example by requiring all staff to complete an annual declaration of interest. However, we have noted that there are some weaknesses in the Authority's systems and approach to the new requirement for all staff to complete an annual declaration of interest. In particular these relate to:</p> <ul style="list-style-type: none"> <li>■ completeness of records to ensure all staff have completed a return;</li> <li>■ for those staff identified to date there has not yet been a 100% return of declarations (it had reached over 90% at the time of our reporting to the September 2016 Audit Committee meeting);</li> <li>■ training should be enhanced to ensure staff understand the importance of the declarations and completing them fully and accurately; and</li> <li>■ obtaining further assurance about the process and consideration/assessment of the returns received and whether any further action is needed in light of the returns both those completed and those not completed.</li> </ul> <p>We will therefore continue to follow up this recommendation in 2017.</p>

# Appendix 1: Position on 2013/14 key issues and recommendations (cont)

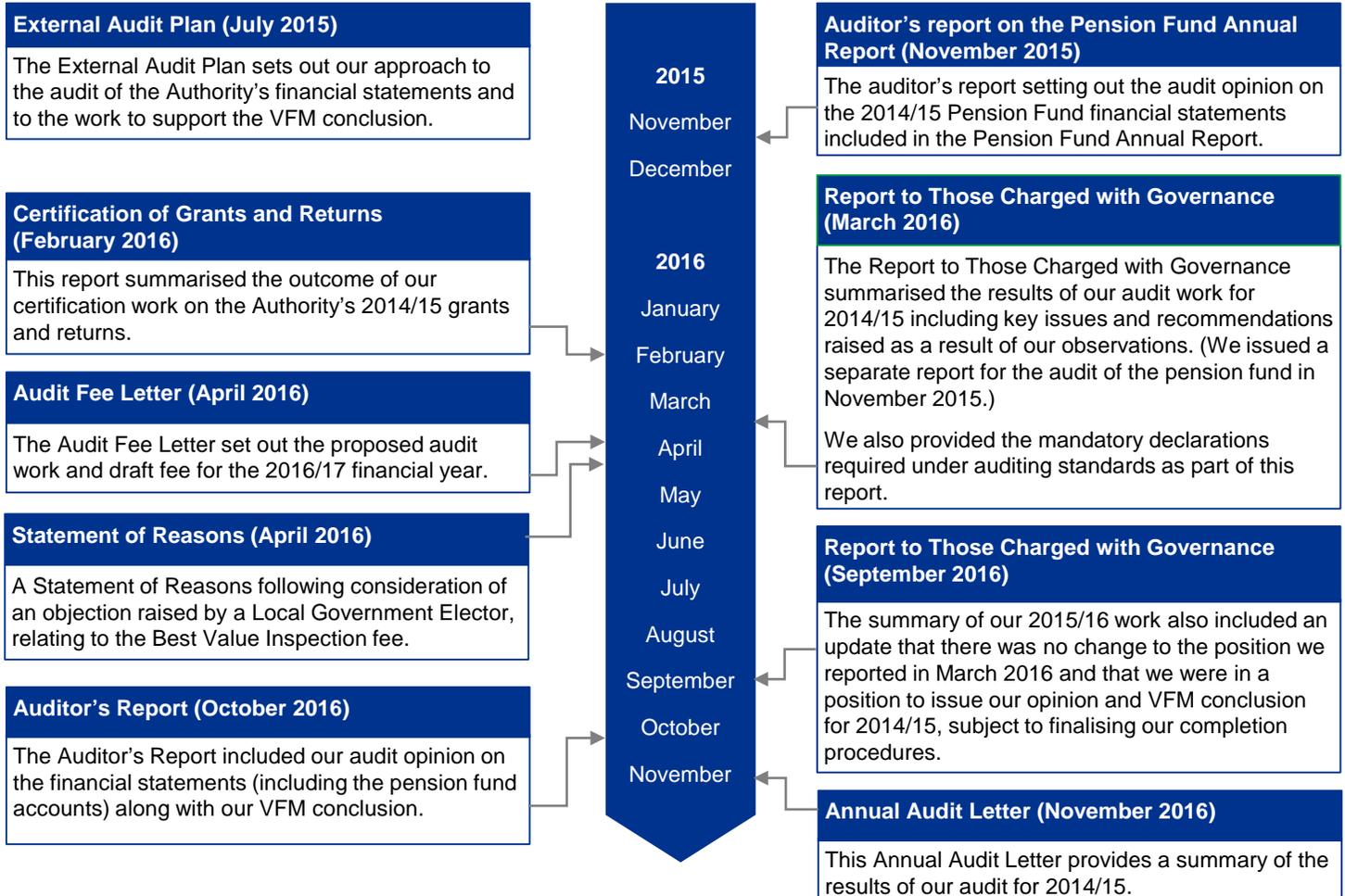
No.	Issue and recommendation	Position as at September 2016
2	<p><b>S106 arrangements</b></p> <p>Our consideration of s106 arrangements highlighted that:</p> <ul style="list-style-type: none"> <li>■ the spreadsheet to record s106 receipts and payments did not cast;</li> <li>■ that certain items appear not to have been paid strictly in line with the original agreements;</li> <li>■ there were funds relating to one scheme that we tested that were close to the deadline for spending the s106 funds, and the plans in place would not be completed before the deadline; and</li> <li>■ there were instances where payments were made in advance of receiving s106 monies, temporarily utilizing other s106 funds.</li> </ul> <p><b>Recommendation</b></p> <p>The Authority should independently review its arrangements in relation to s106 receipts and payments to ensure they are effective and there are robust processes, controls and monitoring arrangements in place to ensure payments are made in accordance with agreements and aligned to original planning consents.</p>	<p>The Authority has had an independent review undertaken of its arrangements in relation to s106 systems, processes, controls and monitoring arrangements.</p> <p>We have considered the results of the independent review and the Authority's response. The review raised a number of recommendations for improvements, which the Authority has responded to positively. The Authority has reported that all recommendations have been implemented except those that required the implementation of a new software system which has been procured and is in the process of being implemented.</p>
3	<p><b>Governance arrangements in schools</b></p> <p>The Annual Internal Audit (IA) Report for Schools 2013/14 states that over half of the schools audited (14 out of 27) fell below the minimum standard of financial control, and management. Internal Audit have also investigated other schools where external referrals alleging irregularity at some schools have been received. Whilst these investigations have not been finalised, it is clear that there are also weaknesses in the governance arrangements of these schools.</p> <p><b>Recommendation</b></p> <p>The Authority should review its governance arrangements for schools and ensure that their effectiveness is improved for all schools and that there are robust mechanisms in place to support schools in understanding their governance responsibilities and provide appropriate guidance, training and support.</p>	<p>The Authority has taken action to reinforce the importance of governance and the role of Governors in managing schools. It has reviewed its guidance and issued the latest guidance to schools and governors. Training and guidance on governance arrangements has been delivered to both Governors and Schools' Business Managers.</p> <p>The Authority is also making further enhancements to arrangements by giving direct support to those schools which have been identified in IA reports as consistently receiving limited assurance through additional workshops delivered by Mazars and Schools Finance.</p> <p>We have considered the impact/progress by liaising with IA on results of recent audits. For 2015/16 the IA annual report shows that of the 25 schools receiving an audit 21 received a 'substantial' assurance rating and 4 had a limited assurance. This represents a significant improvement and positive direction of travel.</p>

# Appendix 1: Position on 2013/14 key issues and recommendations (cont)

No.	Issue and recommendation	Position as at September 2016
4	<p><b>Section 11 recommendation</b></p> <p>In addition to matters raised in the Best Value Inspection report, comments within the Mayoral election judgment and arising from the other matters raised with us as auditors indicated the governance processes had not always been effective.</p> <p>As noted previously in this report various actions are being taken by the Authority (in conjunction with the Commissioners) to address the shortcomings that have been identified. For example the Best Value Action Plans and Mayoral Election Judgment action plan.</p> <p>Whilst we were satisfied that the Authority was taking sufficient steps to address the specific matters identified to date, the extent of matters raised that impact on governance suggested to us that a wider review of governance should be undertaken.</p> <p>We therefore recommended that the Authority should undertake a detailed review of its governance processes across the Authority to satisfy itself that they are appropriate and operating effectively. This should include consideration of the:</p> <ul style="list-style-type: none"> <li>■ roles and responsibilities of the various officers and executive committees and the interaction with members and member committees;</li> <li>■ delegation and escalation processes; and</li> <li>■ the sufficiency of analysis and support in relation to decisions by members, officers and relevant committees.</li> </ul> <p>We also commented that the governance review should be co-ordinated with the other actions being undertaken and proposed including the programme of cultural change.</p>	<p>Our section 11 recommendation centred around the Authority undertaking a detailed review of its governance processes across the Authority to satisfy itself that they are appropriate and operating effectively. We are satisfied that the steps necessary for the Authority to address the matters raised have been integrated into the Organisational Culture Best Value action plan.</p> <p>We will continue monitoring the Authority's progress in implementing the Best Value action plans and undertake testing, as we consider necessary and appropriate, in 2017.</p>

# Appendix 2: Summary of reports issued

This appendix summarises the reports we issued since our last Annual Audit Letter. These reports can be accessed via the Audit Committee pages on the Authority's website at [www.towerhamlets.gov.uk](http://www.towerhamlets.gov.uk).



# Appendix 3: Audit fees

This appendix provides information on our final fees for the 2014/15 audit.

To ensure transparency about the extent of our fee relationship with the Authority we have summarised below the position against the 2014/15 planned audit fee.

### External audit

Our fee to date for the 2014/15 audit of the Authority is £299,529. This compares to a planned fee of £277,290. The reasons for this variance are:

- The objection received from a Local Government Elector relating to the Best Value Inspection fee (£5,922); and
- additional work relating to continuing to follow up the outcome of the Best Value Inspection and considering the Authority's response and additional issues raised with us by the DCLG and Tower Hamlets' Commissioners relating to our audit responsibilities, including payment of grants and related decisions and section 106 agreements (£16,317).

Our final fee for the 2014/15 audit of the Pension Fund was in line with the planned fee of £21,000.

Our fees are still subject to final determination by Public Sector Audit Appointments as we have not yet completed our consideration of an objection relating to Lender Option Borrower Option loans included in the 2014/15 financial statements.

### Certification of grants and returns

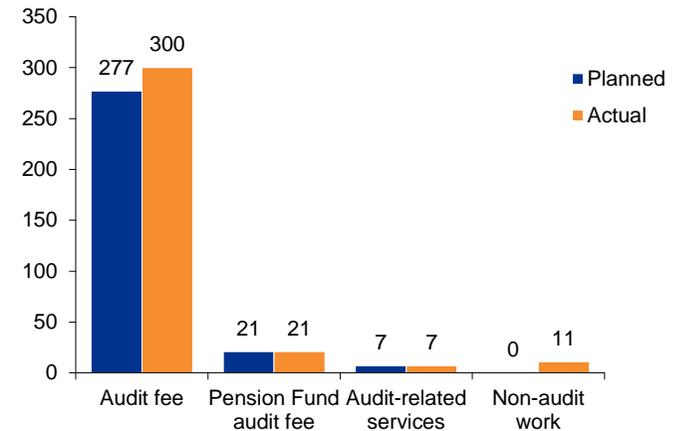
Under our terms of engagement with Public Sector Audit Appointments we undertake prescribed work in order to certify the Authority's housing benefit grant claim. This fee for this certification work was £30,450 which is in line with the scale fee.

### Other services

We charged £6,500 for additional audit-related services for the certification of the capital receipts and teachers' pensions returns, which are outside of Public Sector Audit Appointments' certification regime.

We also charged £11,250 for tax advice. This work was not related to our responsibilities under the Code of Audit Practice.

External audit fees 2014/15 (£'000)





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